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94151—34——1

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 95

CATHERINE LLEWELLYN VAN WART, BY ROY M. VAN WART, Natural Tutor, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 14–15) is not reported. The opinion of the Circuit Court of Appeals (R. 23–26) is reported in 69 F. (2d) 299.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 12, 1934. (R. 26.) The petition for a writ of certiorari was filed June 6, 1934,

and was granted October 8, 1934. (R. 29.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner, a minor, deducted from the gross income reported on her behalf attorneys' fees paid out of her income by her guardian in a suit to reduce to immediate possession accrued income of a trust created for her benefit. The question involved is whether such expenditure is an ordinary and necessary expense paid in carrying on a business.

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 13–16.

STATEMENT

The facts are contained in a stipulation (R. 13–14) and in the decision of the Circuit Court of Appeals for the Fourth Circuit, reported in 295 Fed. 287, which decision by reference was made a part of the stipulation.

During the taxable year 1924, the petitioner was a minor and beneficiary of a trust created by the will of her grandfather. Her duly appointed and qualified tutor or guardian was Roy McLean Van Wart, her father.

The guardian instituted suit to compel the trustees under the grandfather's will to pay over to

him the accumulated income of the trust created in favor of his ward. A favorable decree was finally entered, and, accordingly, the trustees paid to the guardian all of the income which had accumulated.

On April 11, 1924, the guardian, by authority of the court of his appointment, paid out of the funds so received by him, a fee of $30,000 to a firm of attorneys for their services in the litigation.

In the income-tax return for the year 1924 filed by the guardian on behalf of the petitioner, a deduction against gross income of $30,000 was claimed on account of the attorneys' fees paid. The respondent disallowed the deduction, and, on appeal, his action was reversed by the Board of Tax Appeals. (R. 14–15.) The Circuit Court of Appeals, in turn, reversed the Board. (R. 23–26.)

SUMMARY OF ARGUMENT

The petitioner is not entitled to the deduction claimed, for the reasons that she was not engaged in any business, a fact which she concedes; that similar expenditures have been disallowed as personal expenses when made by adults and the statute makes no distinction between a minor and an adult; that she was the taxpayer and not the guardian; that the mere receipt and distribution of the ward's income does not constitute a business carried on by the guardianship; and that neither the guardian nor the guardianship is recognized by the statute as the "taxpayer."

ARGUMENT

The petitioner contends that the attorneys' fees in question are deductible from her gross income as an ordinary and necessary expense paid in carrying on a business. The respondent disallowed the deduction, holding that it was a personal expense.

The petitioner concedes that she was engaged in no business. (Pet. Br. 8.) This concession would appear sufficient to warrant determination of the question here involved against the petitioner. *Hutchings* v. *Burnet,* 58 F. (2d) 514 (App. D. C.); *Commissioner* v. *Field,* 42 F. (2d) 820 (C. C. A. 2d); *Walker* v. *Commissioner,* 63 F. (2d) 351 (C. C. A. 3d), certiorari denied, 289 U. S. 746; *Lindley* v. *Commissioner,* 63 F. (2d) 807 (C. C. A. 2d). Payments made for services of counsel in a suit are ordinary and necessary business expenses and deductible only if the suit is directly connected with, or proximately results from, the taxpayer's business. *Kornhauser* v. *United States,* 276 U. S. 145. That case involved the deductibility of attorneys' fees paid to retain earnings of the taxpayer's business. The same principle would apply to attorneys' fees paid in a suit to recover business income. *Alexander Sprunt & Son* v. *Commissioner,* 64 F. (2d) 424 (C. C. A. 4th). Since petitioner was engaged in no business, there can be no deduction for a business expense.

Expenses similar to the one here involved, when claimed by an adult, have consistently been held to

be of a personal character and not deductible under the statute. (*Lindley, Hutchings, Walker,* and *Field* cases, *supra.*)[1] There appears to be no reason why a different rule should obtain when the expenditure is made by or on behalf of a minor. There is nothing in the statute indicating any such distinction. As the court below said (R. 25):

> In the matter of personal expenses, the income tax law makes no distinction between a minor and an adult taxpayer; it treats them both alike.

The petitioner argues that the attorneys' fees are deductible from her gross income because the expense was paid not by her but by the guardian, and because the guardian, and not she, is the taxpayer. (Pet. Br. 6–8.) The only income tax return involved in these proceedings is that of the petitioner, filed on her behalf by the guardian. The deficiency asserted arises from the elimination of a deduction claimed on her return. If the fees were not paid by her, or paid on her behalf, there would be no foundation for a claim to a deduction from her gross income of the expense here involved. Petitioner assumes that the income reported by her is not her income, but that of the guardian, and that the guardian, and not she, is the taxpayer. From

[1] See also the following decisions of the Board of Tax Appeals to the same effect: *Douglas* v. *Commissioner*, 1 B. T. A. 372; *McConnell* v. *Commissioner*, 3 B. T. A. 260; *Ullman* v. *Commissioner*, 6 B. T. A. 100; *von Echt* v. *Commissioner*, 21 B. T. A. 702.

this assumption, the petitioner argues that the guardian is engaged in the business of administering her affairs and that an expense incurred by him in this administration is an allowable deduction from her gross income.

The statute defines the term "taxpayer" as any person subject to a tax imposed by the Act. Section 2 (a) (9), Revenue Act of 1924, *infra*, p. 13. The term "person" means "an individual, a trust or estate, a partnership, or a corporation." Section 2 (a) (1), *infra*, p. 13. The "individual" subject to the tax is the one having a net income. Section 210 (a), *infra*, p. 13. The only question is whether it is the ward's or the guardian's net income which is subject to the tax. It is submitted that it is the ward's net income which is being taxed, and that she is the taxpayer, and not the guardian.

A guardian has only the custody and management of the ward's property, and title to it is in the ward, and not in the guardian. *Lamar* v. *Micou*, 112 U. S. 452, 472. Payments of funds to the guardian vest title in the ward. *Spicer* v. *Smith*, 288 U. S. 430. An appointee of the court to manage, control and administer the estate of one who, under the law, is incapable of managing his affairs is not a taxpayer. *Linderman* v. *Commissioner*, 28 B. T. A. 113, now pending on appeal before the Circuit Court of Appeals for the Third Circuit. The committee of an incompetent occu-

pies the same status as a guardian. In *Liberman's Committee* v. *Commissioner*, 54 F. (2d) 527 (C. C. A. 2d), the court said (p. 529):

> There is no provision in the 1924 act making the committee of an incompetent the taxpayer. The incompetent remains the taxpayer, although the committee is obliged to make a return for him.

In *Freuler* v. *Helvering*, 291 U. S. 35, this Court said (p. 44):

> Either the minor or his guardian must make the return, but in either case it embraces all the income and is the minor's individual return, not that of the guardian or the trust.

But even assuming that the guardian is the taxpayer, it has not been shown that he was engaged in any business. Occupancy of a fiduciary position does not alone constitute a business. In *Ames* v. *Commissioner*, 49 F. (2d) 853 (C. C. A. 8th), the court said (p. 855):

> Activities of such a taxpayer as an executor, if carried on for the purpose of earning profits may become sufficient to constitute the doing of business, but the execution of his trust by the executor of an estate in the ordinary way of gathering in, administering upon, and distributing the assets should not be so construed. The mere receipt of dividends and the payment of contractual debts shown in this case are but the ordinary incidents of the execution of his trust by an executor. * * *

To the same effect are *Refling* v. *Burnet*, 47 F. (2d) 859 (C. C. A. 8th); *Buckwalter* v. *Commissioner*, 61 F. (2d) 571 (C. C. A. 6th). So far as disclosed by this record, it appears that the guardian was merely the passive recipient of income which he distributed to his ward in the exercise of his discretion. Such activity does not constitute the carrying on of a business.[2]

We are not concerned here with the situation of a guardian claiming, in his own return, a deduction for some expenditure incurred by him in connection with the earning of his commissions as a guardian, as, for instance, rent or clerical hire. Here, the expenditure was made by the guardian on behalf of the ward out of her own income, which

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[2] The decisions of the United States Board of Tax Appeals and the rulings of the Bureau of Internal Revenue cited by the petitioner (Pet. Br. 11, 12) do not specifically hold that, where the administration of an estate or trust consists merely of the gathering in and the distribution of income, such administration constitutes the carrying on of a business. If they may so be read, they are in conflict with *Ames* v. *Commissioner*, *supra*, p. 7.

On page 13 of her brief, the petitioner cites a ruling of the Bureau of Internal Revenue to the effect that an attorney's fee paid by a guardian to secure his appointment to permit his receipt of income for the ward is an ordinary and necessary business expense deductible in the return filed for the ward. The Government has raised the question of deductibility of similar expenditures in the case of *Commissioner* v. *Linderman*, *supra*, which is now pending before the Circuit Court of Appeals for the Third Circuit.

income was not derived by the ward from the operation of any business.

The case of *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509, cited by the petitioner, is clearly distinguishable. In that case, a profit was realized by the estate of a deceased person on a sale made by a trustee of certain shares of capital stock, and the questions presented were whether such profit was constitutionally taxable, and, if so, whether the trustee was required to report the profit and pay the tax thereon. The first question was answered in the affirmative. As to the second question, the Court referred to Section 2 (a) of the Revenue Act of 1916, c. 463, 39 Stat. 756, which defines the net income of a "taxable person." Paragraph (b) of that section provides:

> (b) Income received by estates of deceased persons during the period of administration or settlement of the estate, * * * or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: * * *.
>
> * * * * *

Reference was also made by the Court to the Revenue Act of October 3, 1917, c. 63, 40 Stat. 300, which provides:

> SEC. 1204. (1) * * *
>
> (c) * * * trustees, executors * * * and all persons, corporations, or associations, acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. * * *

The Court concluded (p. 517):

> Thus, it is the plainly expressed purpose of the act of Congress to treat such a trustee as we have here as a "taxable person" and for the purposes of the act to deal with the income received for others precisely as if the beneficiaries had received it in person.

The decision confirms the power of the taxing authorities to look to the trustee for the tax upon profits derived by the trust estate, and to that extent he is a "taxable person". The same power is given under the Revenue Act of 1924, the statute here involved, Sections 219 and 225, *infra*, pp. 14, 15. However, the term "taxable person" is not used in the latter Act. The term used is "taxpayer", and it is specifically defined. It includes a trust or estate, but not a trustee, executor or administrator. Nor does it include a guardian or a guardianship.

On the authority of *Commissioner* v. *Wurts-Dundas*, 54 F. (2d) 515 (C. C. A. 2d), the petitioner argues that the expense of bringing suit against the trustees of the deceased grandfather's estate to secure an immediate distribution of income, was an expense of the guardianship. In the *Wurts-Dundas* case, the court conceived a guardianship as a separate taxable entity. In this, it is submitted, the court erred. No such entity is recognized by the statute. No return is required of it, nor is it liable for any tax. The error arises from the attempted analogy with the status of a trust. A trustee acts for a trust, which the statute recognizes as the "taxpayer", and, therefore, as a taxable entity separate and distinct from either the trustee or the beneficiaries. A guardian acts for a ward, but it is the ward who is recognized as the "taxpayer" by the statute, rather than the guardian or the guardianship, since it is the ward who is the "individual" whose income is being taxed. The statute recognizes neither the trustee nor the guardian as the "taxpayer", though each is charged with the responsibility of filing a return. Sections 219 and 225, *infra*, pp. 14, 15. *Liberman's Committee* v. *Commissioner, supra; Freuler* v. *Helvering, supra.* The analogy must fall, since a guardianship is not recognized in the statute as a taxable entity.

But, assuming *arguendo* the identity of a trust and a guardianship for tax purposes, such conces-

sion would not be helpful to the petitioner, because, even in the case of a trust, it must be shown that the deductions claimed were incurred by the trust in the carrying on of a business. It has not been shown that the guardianship was engaged in any business.

No petition for a writ of certiorari was filed in the *Wurts-Dundas* case, because no conflict of decisions then existed.

CONCLUSION

Since neither the petitioner nor the guardian acting in her behalf was engaged in any business, the expenditure here involved may not be classified as a business expense. We therefore respectfully submit that the decision below is correct and should be affirmed.

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NOVEMBER 1934.

APPENDIX

STATUTE INVOLVED

Revenue Act of 1924, c. 234, 43 Stat. 253:

SEC. 2. (a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

* * * * *

(9) The term "taxpayer" means any person subject to a tax imposed by this Act. [U. S. C., Title 26, Section 1262.]

SEC. 200. When used in this title—

* * * * *

(b) The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person. [U. S. C., Title 26, Section 931.]

SEC. 210. (a) In lieu of the tax imposed by section 210 of the Revenue Act of 1921, there shall be levied, collected, and paid for each taxable year upon the net income of every individual (except as provided in subdivision (b) of this section) a normal tax of 6 per centum of the amount of the net income in excess of the credits provided in section 216, except that in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 2 per centum, and upon the next $4,000 of such excess amount shall be 4 per centum. [U. S. C., Title 26, Section 951.]

SEC. 214. (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *. [U. S. C., Title 26, Section 955.]

SEC. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses. [U. S. C., Title 26, Section 956.]

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on

the same basis as provided in section 212, * * *. [U. S. C., Title 26, Section 960.]

SEC. 225. (a) Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,500 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income;

(4) Every estate or trust the net income of which for the taxable year is $1,000 or over;

(5) Every estate or trust the gross income of which for the taxable year is $5,000 or over, regardless of the amount of the net income; and

(6) Every estate or trust of which any beneficiary is a nonresident alien.

(b) Under such regulations as the Commissioner with the approval of the Secretary may prescribe a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be sufficient compliance with the above requirement. Such fiduciary shall make oath (1)

that he has sufficient knowledge of the affairs of the individual, estate or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct. Any fiduciary required to make a return under this Act shall be subject to all the provisions of this Act which apply to individuals. [U. S. C., Title 26, Section 966.]

U. S. GOVERNMENT PRINTING OFFICE: 1934